

## Internal Revenue Service, Treasury

## § 1.472-8

### § 1.472-5 Revocation of election.

An election made to adopt and use the LIFO inventory method is irrevocable, and the method once adopted shall be used in all subsequent taxable years, unless the use of another method is required by the Commissioner, or authorized by him pursuant to a written application therefor filed as provided in paragraph (e) of § 1.446-1.

[T.D. 6500, 25 FR 11730, Nov. 26, 1960]

### § 1.472-6 Change from LIFO inventory method.

If the taxpayer is granted permission by the Commissioner to discontinue the use of LIFO method of taking inventories, and thereafter to use some other method, or if the taxpayer is required by the Commissioner to discontinue the use of the LIFO method by reason of the taxpayer's failure to conform to the requirements detailed in § 1.472-2, the inventory of the specified goods for the first taxable year affected by the change and for each taxable year thereafter shall be taken—

(a) In conformity with the method used by the taxpayer under section 471 in inventorying goods not included in his LIFO inventory computations; or

(b) If the LIFO inventory method was used by the taxpayer with respect to all of his goods subject to inventory, then in conformity with the inventory method used by the taxpayer prior to his adoption of the LIFO inventory method; or

(c) If the taxpayer had not used inventories prior to his adoption of the LIFO inventory method and had no goods currently subject to inventory by a method other than the LIFO inventory method, then in conformity with such inventory method as may be selected by the taxpayer and approved by the Commissioner as resulting in a clear reflection of income; or

(d) In any event, in conformity with any inventory method to which the taxpayer may change pursuant to application approved by the Commissioner.

[T.D. 6500, 25 FR 11730, Nov. 26, 1960]

### § 1.472-7 Inventories of acquiring corporations.

For additional rules in the case of certain corporate acquisitions specified in section 381(a), see section 381(c)(5) and the regulations thereunder.

[T.D. 6500, 25 FR 11730, Nov. 26, 1960]

### § 1.472-8 Dollar-value method of pricing LIFO inventories.

(a) *Election to use dollar-value method.* Any taxpayer may elect to determine the cost of his LIFO inventories under the so-called "dollar-value" LIFO method, provided such method is used consistently and clearly reflects the income of the taxpayer in accordance with the rules of this section. The dollar-value method of valuing LIFO inventories is a method of determining cost by using "base-year" cost expressed in terms of total dollars rather than the quantity and price of specific goods as the unit of measurement. Under such method the goods contained in the inventory are grouped into a pool or pools as described in paragraphs (b) and (c) of this section. The term "base-year cost" is the aggregate of the cost (determined as of the beginning of the taxable year for which the LIFO method is first adopted, i.e., the base date) of all items in a pool. The taxable year for which the LIFO method is first adopted with respect to any item in the pool is the "base year" for that pool, except as provided in paragraph (g)(3) of this section. Liquidations and increments of items contained in the pool shall be reflected only in terms of a net liquidation or increment for the pool as a whole. Fluctuations may occur in quantities of various items within the pool, new items which properly fall within the pool may be added, and old items may disappear from the pool, all without necessarily effecting a change in the dollar value of the pool as a whole. An increment in the LIFO inventory occurs when the end of the year inventory for any pool expressed in terms of base-year cost is in excess of the beginning of the year inventory for that pool expressed in terms of base-year cost. In determining the inventory value for a pool, the increment, if any, is adjusted for changing

unit costs or values by reference to a percentage, relative to base-year-cost, determined for the pool as a whole. See paragraph (e) of this section. See also paragraph (f) of this section for rules relating to the change to the dollar-value LIFO method from another LIFO method.

(b) *Principles for establishing pools of manufacturers and processors*—(1) *Natural business unit pools*. A pool shall consist of all items entering into the entire inventory investment for a natural business unit of a business enterprise, unless the taxpayer elects to use the multiple pooling method provided in subparagraph (3) of this paragraph. Thus, if a business enterprise is composed of only one natural business unit, one pool shall be used for all of its inventories, including raw materials, goods in process, and finished goods. If, however, a business enterprise is actually composed of more than one natural business unit, more than one pool is required. Where similar types of goods are inventoried in two or more natural business units of the taxpayer, the Commissioner may apportion or allocate such goods among the various natural business units, if he determines that such apportionment or allocation is necessary in order to clearly reflect the income of such taxpayer. Where a manufacturer or processor is also engaged in the wholesaling or retailing of goods purchased from others, any pooling of the LIFO inventory of such purchased goods for the wholesaling or retailing operations shall be determined in accordance with the rules of paragraph (c) of this section.

(2) *Definition of natural business unit*.

(i) Whether an enterprise is composed of more than one natural business unit is a matter of fact to be determined from all the circumstances. The natural business divisions adopted by the taxpayer for internal management purposes, the existence of separate and distinct production facilities and processes, and the maintenance of separate profit and loss records with respect to separate operations are important considerations in determining what is a business unit, unless such divisions, facilities, or accounting records are set up merely because of differences in

geographical location. In the case of a manufacturer or processor, a natural business unit ordinarily consists of the entire productive activity of the enterprise within one product line or within two or more related product lines including (to the extent engaged in by the enterprise) the obtaining of materials, the processing of materials, and the selling of manufactured or processed goods. Thus, in the case of a manufacturer or processor, the maintenance and operation of a raw material warehouse does not generally constitute, of itself, a natural business unit. If the taxpayer maintains and operates a supplier unit the production of which is both sold to others and transferred to a different unit of the taxpayer to be used as a component part of another product, the supplier unit will ordinarily constitute a separate and distinct natural business unit. Ordinarily, a processing plant would not in itself be considered a natural business unit if the production of the plant, although saleable at this stage, is not sold to others, but is transferred to another plant of the enterprise, not operated as a separate division, for further processing or incorporation into another product. On the other hand, if the production of a manufacturing or processing plant is transferred to a separate and distinct division of the taxpayer, which constitutes a natural business unit, the supplier unit itself will ordinarily be considered a natural business unit. However, the mere fact that a portion of the production of a manufacturing or processing plant may be sold to others at a certain stage of processing with the remainder of the production being further processed or incorporated into another product will not of itself be determinative that the activities devoted to the production of the portion sold constitute a separate business unit. Where a manufacturer or processor is also engaged in the wholesaling or retailing of goods purchased from others, the wholesaling or retailing operations with respect to such purchased goods shall not be considered a part of any manufacturing or processing unit.

(ii) The rules of this subparagraph may be illustrated by the following examples:

*Example (1).* A corporation manufactures, in one division, automatic clothes washers and driers of both commercial and domestic grade as well as electric ranges, mangles, and dishwashers. The corporation manufactures, in another division, radios and television sets. The manufacturing facilities and processes used in manufacturing the radios and television sets are distinct from those used in manufacturing the automatic clothes washers, etc. Under these circumstances, the enterprise would consist of two business units and two pools would be appropriate, one consisting of all of the LIFO inventories entering into the manufacture of clothes washers and driers, electric ranges, mangles, and dishwashers and the other consisting of all of the LIFO inventories entering into the production of radio and television sets.

*Example (2).* A taxpayer produces plastics in one of its plants. Substantial amounts of the production are sold as plastics. The remainder of the production is shipped to a second plant of the taxpayer for the production of plastic toys which are sold to customers. The taxpayer operates his plastics plant and toy plant as separate divisions. Because of the different product lines and the separate divisions the taxpayer has two natural business units.

*Example (3).* A taxpayer is engaged in the manufacture of paper. At one stage of processing, uncoated paper is produced. Substantial amounts of uncoated paper are sold at this stage of processing. The remainder of the uncoated paper is transferred to the taxpayer's finishing mill where coated paper is produced and sold. This taxpayer has only one natural business unit since coated and uncoated paper are within the same product line.

(3) *Multiple pools*—(i) *Principles for establishing multiple pools.* (a) A taxpayer may elect to establish multiple pools for inventory items which are not within a natural business unit as to which the taxpayer has adopted the natural business unit method of pooling as provided in subparagraph (1) of this paragraph. Each such pool shall ordinarily consist of a group of inventory items which are substantially similar. In determining whether such similarity exists, consideration shall be given to all the facts and circumstances. The formulation of detailed rules for selection of pools applicable to all taxpayers is not feasible. Important considerations to be taken into account include, for example, whether there is substantial similarity in the types of raw materials used or in the processing operations applied;

whether the raw materials used are readily interchangeable; whether there is similarity in the use of the products; whether the groupings are consistently followed for purposes of internal accounting and management; and whether the groupings follow customary business practice in the taxpayer's industry. The selection of pools in each case must also take into consideration such factors as the nature of the inventory items subject to the dollar-value LIFO method and the significance of such items to the taxpayer's business operations. Where similar types of goods are inventoried in natural business units and multiple pools of the taxpayer, the Commissioner may apportion or allocate such goods among the natural business units and the multiple pools, if he determines that such apportionment or allocation is necessary in order to clearly reflect the income of the taxpayer.

(b) Raw materials which are substantially similar shall be pooled together in accordance with the principles of this subparagraph. However, inventories of raw or unprocessed materials of an unlike nature may not be placed into one pool, even though such materials become part of otherwise identical finished products.

(c) Finished goods and goods-in-process in the inventory shall be placed into pools classified by major classes or types of goods. The same class or type of finished goods and goods-in-process shall ordinarily be included in the same pool. Where the material content of a class of finished goods and goods-in-process included in a pool has been changed, for example, to conform with current trends in an industry, a separate pool of finished goods and goods-in-process will not ordinarily be required unless the change in material content results in a substantial change in the finished goods.

(d) The requirement that pools be established by major types of materials or major classes of goods is not to be construed so as to preclude the establishment of a miscellaneous pool. Since a taxpayer may elect the dollar-value LIFO method with respect to all or any designated goods in his inventory, there may be a number of such inventory items covered in the election. A

miscellaneous pool shall consist only of items which are relatively insignificant in dollar value by comparison with other inventory items in the particular trade or business and which are not properly includible as part of another pool.

(ii) *Raw materials content pools.* The dollar-value method of pricing LIFO inventories may be used in conjunction with the raw materials content method authorized in § 1.472-1. Raw materials (including the raw material content of finished goods and goods-in-process) which are substantially similar shall be pooled together in accordance with the principles of subdivision (i) of this subparagraph. However, inventories of materials of an unlike nature may not be placed into one pool, even though such materials become part of otherwise identical finished products.

(c) *Principles for establishing pools for wholesalers, retailers, etc.* Items of inventory in the hands of wholesalers, retailers, jobbers, and distributors shall be placed into pools by major lines, types, or classes of goods. In determining such groupings, customary business classifications of the particular trade in which the taxpayer is engaged is an important consideration. An example of such customary business classification is the department in the department store. In such case, practices are relatively uniform throughout the trade, and departmental grouping is peculiarly adapted to the customs and needs of the business. However, in appropriate cases, the principles set forth in paragraphs (b) (1) and (2) of this section, relating to pooling by natural business units, may be used, with permission of the Commissioner, by wholesalers, retailers, jobbers, or distributors. Where a wholesaler or retailer is also engaged in the manufacturing or processing of goods, the pooling of the LIFO inventory for the manufacturing or processing operations shall be determined in accordance with the rules of paragraph (b) of this section.

(d) *Determination of appropriateness of pools.* Whether the number and the composition of the pools used by the taxpayer is appropriate, as well as the propriety of all computations incidental to the use of such pools, will be

determined in connection with the examination of the taxpayer's income tax returns. Adequate records must be maintained to support the base-year unit cost as well as the current-year unit cost for all items priced on the dollar-value LIFO inventory method, regardless of the method authorized by paragraph (e) of this section which is used in computing the LIFO value of the dollar-value pool. The pool or pools selected must be used for the year of adoption and for all subsequent taxable years unless a change is required by the Commissioner in order to clearly reflect income, or unless permission to change is granted by the Commissioner as provided in paragraph (e) of § 1.446-1. However, see paragraph (h) of this section for authorization to change the method of pooling in certain specified cases.

(e) *Methods of computation of the LIFO value of a dollar-value pool—(1) Methods authorized.* A taxpayer may ordinarily use only the so-called “double-extension” method for computing the base-year and current-year cost of a dollar-value inventory pool. Where the use of the double-extension method is impractical, because of technological changes, the extensive variety of items, or extreme fluctuations in the variety of the items, in a dollar-value pool, the taxpayer may use an index method for computing all or part of the LIFO value of the pool. An index may be computed by double-extending a representative portion of the inventory in a pool or by the use of other sound and consistent statistical methods. The index used must be appropriate to the inventory pool to which it is to be applied. The appropriateness of the method of computing the index and the accuracy, reliability, and suitability of the use of such index must be demonstrated to the satisfaction of the district director in connection with the examination of the taxpayer's income tax returns. The use of any so-called “link-chain” method will be approved for taxable years beginning after December 31, 1960, only in those cases where the taxpayer can demonstrate to the satisfaction of the district director that the use of either an index method or the double-extension method would be impractical or unsuitable in view of

the nature of the pool. A taxpayer using either an index or link-chain method shall attach to his income tax return for the first taxable year beginning after December 31, 1960, for which the index or link-chain method is used, a statement describing the particular link-chain method or the method used in computing the index. The statement shall be in sufficient detail to facilitate the determination as to whether the method used meets the standards set forth in this subparagraph. In addition, a copy of the statement shall be filed with the Commissioner of Internal Revenue, Attention: T:R, Washington, D.C. 20224. The taxpayer shall submit such other information as may be requested with respect to such index or link-chain method. Adequate records must be maintained by the taxpayer to support the appropriateness, accuracy, and reliability of an index or link-chain method. A taxpayer may request the Commissioner to approve the appropriateness of an index or link-chain method for the first taxable year beginning after December 31, 1960, for which it is used. Such request must be submitted within 90 days after the beginning of the first taxable year beginning after December 31, 1960, in which the taxpayer desires to use the index or link-chain method, or on or before May 1, 1961, whichever is later. A taxpayer entitled to use the retail method of pricing LIFO inventories authorized by paragraph (k) of § 1.472-1 may use retail price indexes prepared by the United States Bureau of Labor Statistics. Any method of computing the LIFO value of a dollar-value pool must be used for the year of adoption and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner in accordance with paragraph (e) of § 1.446-1 to use a different method.

(2) *Double-extension method.* (i) Under the double-extension method the quantity of each item in the inventory pool at the close of the taxable year is extended at both base-year unit cost and current-year unit cost. The respective extensions at the two costs are then each totaled. The first total gives the amount of the current inventory in terms of base-year cost and the second total gives the amount of such inventory in terms of current-year cost.

(ii) The total current-year cost of items making up a pool may be determined—

(a) By reference to the actual cost of the goods most recently purchased or produced;

(b) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(c) By application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced; or

(d) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

(iii) Under the double-extension method a base-year unit cost must be ascertained for each item entering a pool for the first time subsequent to the beginning of the base year. In such a case, the base-year unit cost of the entering item shall be the current-year cost of that item unless the taxpayer is able to reconstruct or otherwise establish a different cost. If the entering item is a product or raw material not in existence on the base date, its cost may be reconstructed, that is, the taxpayer using reasonable means may determine what the cost of the item would have been had it been in existence in the base year. If the item was in existence on the base date but not stocked by the taxpayer, he may establish, by using available data or records, what the cost of the item would have been to the taxpayer had he stocked the item. If the base-year unit cost of the entering item is either reconstructed or otherwise established to the satisfaction of the Commissioner, such cost may be used as the base-year unit cost in applying the double-extension method. If the taxpayer does not reconstruct or establish to the satisfaction of the Commissioner a base-year unit cost, but does reconstruct or establish to the satisfaction of the Commissioner the cost of the item at some year subsequent to the base year, he may use the earliest cost which he does reconstruct or establish as the base-year unit cost.

(iv) To determine whether there is an increment or liquidation in a pool for a

§ 1.472-8

26 CFR Ch. I (4-1-01 Edition)

particular taxable year, the end of the year inventory of the pool expressed in terms of base-year cost is compared with the beginning of the year inventory of the pool expressed in terms of base-year cost. When the end of the year inventory of the pool is in excess of the beginning of the year inventory of the pool an increment occurs in the pool for that year. If there is an increment for the taxable year, the ratio of the total current-year cost of the pool to the total base-year cost of the pool must be computed. This ratio when multiplied by the amount of the increment measured in terms of base-year cost gives the LIFO value of such increment. The LIFO value of each such increment is hereinafter referred to in this section as the "layer of increment" and must be separately accounted for and a record thereof maintained as a separate layer of the pool, and may not be combined with a layer of increment occurring in a different year. On the other hand, when the end of the year inventory of the pool is less than the beginning of the year inventory of the pool, a liquidation occurs in the pool for that year. Such liquidation is to be reflected by reducing the most recent layer of increment by the excess of the beginning of the year inventory over the end of the year inventory of the pool. However, if the amount of the liquidation exceeds the amount of the most recent layer of increment, the preceding layers of increment in reverse chronological order are to be successively reduced by the amount of such excess until all the excess is absorbed. The base-year inventory is to be reduced by liquidation only to the extent that the aggregate of all liquidation exceeds the aggregate of all layers of increment.

(v) The following examples illustrate inventories under the double-extension method.

*Example (1).* (a) A taxpayer elects, beginning with the calendar year 1961, to compute his inventories by use of the LIFO inventory method under section 472 and further elects to use the dollar-value method in pricing such inventories as provided in paragraph (a) of this section. He creates Pool No. 1 for items A, B, and C. The composition of the inventory for Pool No. 1 at the base date, January 1, 1961, is as follows:

Items	Units	Unit cost	Total cost
A .....	1,000	\$5	\$5,000
B .....	2,000	4	8,000
C .....	500	2	1,000
Total base-year cost at Jan. 1, 1961 .....			14,000

(b) The closing inventory of Pool No. 1 at December 31, 1961, contains 3,000 units of A, 1,000 units of B, and 500 units of C. The taxpayer computes the current-year cost of the items making up the pool by reference to the actual cost of goods most recently purchased. The most recent purchases of items A, B, and C are as follows:

Item	Purchase date	Quantity purchased	Unit cost
A .....	Dec. 15, 1961 .....	3,500	\$6.00
B .....	Dec. 10, 1961 .....	2,000	5.00
C .....	Nov. 1, 1961 .....	500	2.50

(c) The inventory of Pool No. 1 at December 31, 1961, shown at base-year and current-year cost is as follows:

Item	Quantity	Dec. 31, 1961, inventory at Jan. 1, 1961, base-year cost		Dec. 31, 1961, inventory at current-year cost	
		Unit cost	Amount	Unit cost	Amount
A .....	3,000	\$5.00	\$15,000	\$6.00	\$18,000
B .....	1,000	4.00	4,000	5.00	5,000
C .....	500	2.00	1,000	2.50	1,250
Total .....			20,000		24,250

(d) If the amount of the December 31, 1961, inventory at base-year cost were equal to, or less than, the base-year cost of \$14,000 at January 1, 1961, such amount would be the closing LIFO inventory at December 31, 1961. However, since the base-year cost of the closing LIFO inventory at December 31, 1961, amounts to \$20,000, and is in excess of the \$14,000 base-year cost of the opening inventory for that year, there is a \$6,000 increment in Pool No. 1 during the year. This increment must be valued at current-year cost, i.e., the ratio of 24,250/20,000, or 121.25 percent. The LIFO value of the inventory at December 31, 1961, is \$21,275, computed as follows:

POOL No. 1

	Dec. 31, 1961, inventory at Jan. 1, 1961, base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1961, inventory at LIFO value
Jan. 1, 1961, base cost	14,000	100.00	\$14,000

## Internal Revenue Service, Treasury

## § 1.472-8

POOL NO. 1—Continued

	Dec. 31, 1961, inventory at Jan. 1, 1961, base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1961, inventory at LIFO value
Dec. 31, 1961, increment .....	6,000	121.25	7,275
Total .....	20,000	.....	21,275

*Example (2).* (a) Assume the taxpayer in example (1) during the year 1962 completely disposes of item C and purchases item D. Assume further that item D is properly includible in Pool No. 1 under the provisions of this section. The closing inventory on December 31, 1962, consists of quantities at current-year unit cost, as follows:

Items	Units	Current-year unit cost Dec. 31, 1962
A .....	2,000	\$6.50
B .....	1,500	6.00
D .....	1,000	5.00

(b) The taxpayer establishes that the cost of item D, had he acquired it on January 1, 1961, would have been \$2.00 per unit. Such cost shall be used as the base-year unit cost for item D, and the LIFO computations at December 31, 1962, are made as follows:

Item	Quantity	Dec. 31, 1962, inventory at Jan. 1, 1961, base-year cost		Dec. 31, 1962, inventory at current-year cost	
		Unit cost	Amount	Unit cost	Amount
A .....	2,000	\$5.00	\$10,000	\$6.50	\$13,000
B .....	1,500	4.00	6,000	6.00	9,000
D .....	1,000	2.00	2,000	5.00	5,000
Total .....	.....	.....	18,000	.....	27,000

(c) Since the closing inventory at base-year cost, \$18,000, is less than the 1962 opening inventory at base-year cost, \$20,000, a liquidation of \$2,000 has occurred during 1962. This liquidation is to be reflected by reducing the most recent layer of increment. The LIFO value of the inventory at December 31, 1962, is \$18,850, and is summarized as follows:

POOL NO. 1

	Dec. 31, 1962, inventory at Jan. 1, 1961, base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1962, inventory at LIFO value
Jan. 1, 1961, base cost	14,000	100.00	\$14,000
Dec. 31, 1961, increment .....	4,000	121.25	4,850
Total .....	18,000	.....	18,850

(3) *Use of inventory price index computed with reference to consumer or producer price indexes*—(i) *In general.* For purposes of paragraph (e)(1) of this section, for taxable years beginning after December 31, 1981, an inventory price index computed in the manner provided by paragraph (e)(3) will be accepted by the Commissioner as an appropriate method of computing an index, and the use of such inventory price index to compute the LIFO value of a dollar-value inventory pool will be accepted as accurate, reliable, and suitable. A taxpayer using the inventory price index computation method provided by paragraph (e)(3) must use such method in determining the value of all goods for which the taxpayer has elected to use the LIFO method. However, the inventory price index computation method provided by paragraph (e)(3) may not be used by a taxpayer eligible to use inventory price indexes prepared by the United States Bureau of Labor Statistics for the purpose of valuing the LIFO inventories of a specific industry. Thus, a taxpayer eligible to use the retail price indexes prepared by the Bureau of Labor Statistics and published in *Department Store Inventory Price Indexes* may not use the inventory price index computation method provided by paragraph (e)(3). An inventory price index computed as provided by paragraph (e)(3) is computed in the manner provided by paragraph (e)(3)(ii) with reference to consumer or producer price indexes selected in the manner provided by paragraph (e)(3)(iii). Special rules for establishing inventory

pools to be valued by an inventory price index computed in the manner provided by paragraph (e)(3) are in paragraph (e)(3)(iv). Rules relating to the adoption of, or change to, the method of computing an inventory price index in the manner provided by paragraph (e)(3) are in paragraph (e)(3)(v) and (vi).

(ii) *Computation of index.* An inventory price index computed in the manner provided by this (ii) shall be a stated percentage of the percent change in the selected consumer or producer price index or indexes for a specific category or categories of goods. The stated percentage for a taxpayer in a taxable year in which it is an eligible small business, as defined by section 474(b) of the Code, shall be 100 percent of the percent change in the selected price indexes. The stated percentage for all other taxpayers shall be 80 percent of the percent change in the selected price indexes.

See paragraph (e)(3)(iii) of this section for rules relating to the selection of appropriate consumer or producer price indexes. Thus, if the selected consumer or producer price index for a specific category of goods increased 10 percent for the period December 1981 to December 1982, an inventory price index computed in the manner provided by this (ii) with reference to such consumer or producer price index will reflect an increase of either 10 percent for an eligible small business or 8 percent (80 percent of 10 percent) for all other taxpayers. If the selected consumer or producer price index for a specific category of goods increased 10 percent per year for the period December 1981 to December 1983, an inventory price index computed in the manner provided by this (ii) with reference to such consumer or producer price index will reflect an increase of either 21 percent for an eligible small business or 16.8 percent (80 percent of 21 percent) for all other taxpayers. If under paragraph (e)(3)(iii) it is necessary to select more than one specific consumer or producer price index for an inventory pool, the stated percentage of the percent change in such indexes is the stated percentage of the weighted average percent change for such indexes. Such weighted average is computed with ref-

erence to the relative amounts of costs in the inventory pool for each index category of goods. The costs to be used in computing such weighted average must be the relative current-year costs in ending inventory.

(iii) *Selection of consumer or producer price indexes—(A) In general.* An inventory price index computed as provided by paragraph (e)(3) of this section is computed with reference to the consumer or producer price indexes for specific categories of inventory items in the *CPI Detailed Report* or *Producer Prices and Price Indexes* published by the United States Bureau of Labor Statistics.

(B) *Selection of indexes by category of inventory items.* The selection of consumer or producer price indexes for an inventory pool is accomplished via a two-step process. First, the inventory items in each pool should be classified according to the detailed listings in the appropriate tables of the *CPI Detailed Report* or in *Producer Prices and Price Indexes* and assigned an index category. Second, an appropriate consumer or producer price index must be determined for each index category to which inventory items have been assigned. The assignment of index categories to the taxpayer's inventory items is accomplished by a process of elimination as follows:

(1) Whenever a specific inventory item in the taxpayer's inventory comprises 10 percent or more of total inventory value, such an inventory item must be placed in its own, separate index category. The index category selected must be the most detailed index category which includes that specific inventory item. In addition, any other inventory item that is included in such most detailed index category must also be included in such index category.

(2) If there are inventory items still remaining in the pool that have not been included in an index category, the taxpayer, beginning with the most detailed index categories for such remaining inventory items, must investigate successively less detailed index category levels and select the first index category that contains remaining inventory items which in the aggregate comprise 10 percent or more of

total inventory value. The index category so selected must be the separate index category for the included inventory items. This procedure must be repeated either until all inventory items in the pool have been included in an index category, or until the remaining inventory items in the aggregate comprise less than 10 percent of total inventory value, or until it has been determined that no appropriate index category exists for the aggregate of such remaining inventory items.

(3) If there are inventory items remaining in the pool that comprise less than 10 percent of total inventory value, the index category to be selected for these inventory items must be the most detailed index category that includes such inventory items. If it has been determined that no appropriate index category exists for such remaining inventory items, such remaining inventory items must be combined in a miscellaneous index category created by the taxpayer.

In no event shall an index category be selected that is less detailed than either the 11 general categories of consumer goods described in Tables 3 and 5 of the *CPI Detailed Report* (see paragraph (e)(3)(iv) of this section), or the 15 general categories of producer goods described in Table 6 of the *Producer Prices and Price Indexes*. The determination of the appropriate index for an index category is accomplished as follows:

(4) Whenever an index category has been selected pursuant to paragraph (e)(3)(iii)(B)(1) of this section the appropriate index must be the published index for that index category.

(5) Whenever an index category has been selected pursuant to paragraph (e)(3)(iii)(B)(2) or (3) of this section, the appropriate index must be a weighted average of the published indexes of the index category items actually present in the taxpayer's inventory, excluding any index category items that have been placed in any other separate index category, weighted according to the weights used by BLS. Thus, if a taxpayer's inventory contains every inventory item that comprises the selected index category and none of these inventory items have been placed in any other separate index

category, the appropriate index must be the published index for that index category. In the case of a miscellaneous index category created by the taxpayer, the appropriate index must be a weighted average of the published indexes for the index category items, weighted according to the weights used by BLS.

The use of BLS weights is limited only to the determination of the appropriate index for an index category. In computing the index for a pool, the taxpayer will weight the appropriate indexes for the separate index categories comprising the pool according to the taxpayer's actual inventory weights for such separate index categories. Whether the selection of the consumer or producer price indexes to be used to compute an inventory price index is appropriate, and the propriety of all computations incidental to the use of such consumer or producer price indexes, will be determined in connection with the examination of the taxpayer's income tax return. The selection of a consumer or producer price index for a specific good to compute an inventory price index under paragraph (e)(3) is a method of accounting. A taxpayer desiring to change the selection of such a consumer or producer price index must secure the consent of the Commissioner as provided in § 1.446-1(e). In the case of such a change, any layers of inventory increments previously determined and the LIFO value of such increments shall be retained. Instead of using the earliest taxable year for which the taxpayer adopted the LIFO method for any items in the inventory pool, the year of such change shall be used as the base year in determining the LIFO value of the inventory pool for the year of change and later taxable years. The base year costs of layers of increments in the pool at the beginning of the year of change shall be restated in terms of new base year costs using the year of change as the new base year.

(C) *Other selection requirements.* Manufacturers, processors, wholesalers, jobbers, and distributors may select indexes from only *Producer Prices and*

*Price Indexes.* Retailers may select indexes from either the *CPI Detailed Report* or *Producer Prices and Price Indexes*, but if equally appropriate indexes could be selected from either publication, a retailer using the retail inventory method must select the index from the *CPI Detailed Report* and a retailer not using the retail inventory method must select the index from *Producer Prices and Price Indexes*. If a retailer using the retail inventory method selects a price index from *Producer Prices and Price Indexes*, the selected index must be converted into a retail price index. If a retailer not using the retail inventory method selects an index from the *CPI Detailed Report*, the selected index must be converted into a cost price index. Manufacturers, processors, wholesalers, jobbers, and distributors must convert selected indexes into cost price indexes. In the case of the *CPI Detailed Report*, indexes may be selected only from Table 3 (Consumer Price Index for All Urban Consumers: Food expenditure categories, U.S. city average) and Table 5 (Consumer Price Index for All Urban Consumers: Nonfood expenditure categories, U.S. city average). In the case of the *Producer Prices and Price Indexes*, indexes may be selected only from Table 6 (Producer prices and price indexes for commodity groupings and individual items), unless the taxpayer can demonstrate that the selection of an index from another *Producer Prices and Price Indexes* table would be more appropriate. In the case of a taxpayer using the retail inventory method, the selected index must be the index as of the last month of the taxpayer's taxable year. Taxpayers that do not use the retail inventory method must select indexes as of the month or months most appropriate to the taxpayer's method of determining the current-year cost of the inventory pool under paragraph (e)(2)(ii) of this section, or make a one-time binding election of an appropriate representative month during the taxable year. The election must be clearly set forth on Form 970 (see paragraph (e)(3)(v) of this section).

(iv) *Special rules for pools.* A retailer, wholesaler, jobber, or distributor computing an inventory price index in the manner provided by paragraph (e)(3) of

this section may, at the option of the taxpayer, establish an inventory pool for any group of goods included within one of eleven general categories of consumer goods described in the *CPI Detailed Report*. The eleven categories are food and beverages, housing maintenance and repair commodities, fuels (other than gasoline), house furnishings and housekeeping supplies, apparel commodities, private transportation (including gasoline), medical care commodities, entertainment commodities, tobacco products, toilet goods and personal care appliances, and school books and supplies. Inventory pools that comprise less than 5 percent of inventory value may be combined to form a single miscellaneous inventory pool. If the resulting miscellaneous inventory pool itself comprises less than 5 percent of inventory value, such pool may be combined only with the largest inventory pool. See paragraphs (b), (c) and (d) of this section for additional rules relating to the establishment of pools. See also section 474 of the Code for rules relating to the use of a single pool by an eligible small business. Except as provided in paragraph (e)(3)(v) of this section, relating to the adoption or change of method of computing an inventory price index, the rules of paragraph (g)(1) and (2) of this section apply to a change in method of pooling.

(v) *Adoption or change of method.* The use of an inventory price index computed in the manner provided by paragraph (e)(3) of this section is considered a method of accounting. A taxpayer permitted to adopt or change to the dollar-value LIFO inventory method without first securing the consent of the Commissioner may also adopt the inventory price index computation method prescribed by paragraph (e)(3) incident to such adoption or change without first securing the consent of the Commissioner. In all other cases, a taxpayer may adopt or change to the inventory price index computation method prescribed by paragraph (e)(3) only after first securing the consent of the Commissioner as provided in § 1.446-1(e). However, in the case of a taxpayer not using the inventory price index computation method prescribed by paragraph (e)(3), the taxpayer may adopt or change to such method for the

taxpayer's first or second taxable year beginning after December 31, 1981, without requesting the Commissioner's consent to such adoption or change. In addition, in such a case the taxpayer is not required to request the Commissioner's consent to a change in method of pooling incident to such adoption or change if the taxpayer is changing to a method of pooling authorized by paragraph (e)(3)(iv). In this case the rules of § 1.472-8(g) will apply. The inventory price index computation method provided by paragraph (e)(3) may be adopted and used only if the taxpayer indicates on a Form 970, or in such other manner as may be acceptable to the Commissioner, a listing of each inventory pool, the type of goods included in each pool, and the consumer or producer price index or indexes selected for each inventory pool. In the case of a taxpayer permitted to adopt or change to the inventory price index computation method without requesting the Commissioner's consent, the Form 970 shall be attached to the taxpayer's income tax return for the taxable year of such adoption or change. In other cases, the Form 970 shall be attached to a Form 3115 filed in accordance with § 1.446-1(e). Taxpayers must maintain adequate books and records of the use and computation of the inventory price index method in order to satisfy the requirements of § 1.472-2(h). Notwithstanding the rules in paragraph (e)(1) of this section, a taxpayer adopting or changing to the use of an inventory price index computed in the manner provided by paragraph (e)(3) is not required to demonstrate that the use of the double-extension method is impractical.

(vi) *Requirement incident to change.* In the case of a taxpayer using a method other than an inventory price index computed as prescribed by paragraph (e)(3) of this section to determine the LIFO value of a dollar-value inventory pool, any layers of inventory increments previously determined by such method and the LIFO value of such layers shall be retained if the taxpayer changes to the use of a price index computed as prescribed by paragraph (e)(3). Instead of using the earliest taxable year for which the taxpayer adopted the LIFO method for any items in

the pool, the year of such change shall be used as the base year in determining the LIFO value of the inventory pool for the year of change and later taxable years. The base year costs of layers of increments in the pool at the beginning of the year of change shall be restated in terms of new base year cost, using the year of change as the new base year. See paragraph (f)(2) of this section for rules relating to a change to the dollar-value method from another method of pricing LIFO inventories.

(f) *Change to dollar-value method from another method of pricing LIFO inventories*—(1) *Consent required.* Except as provided in § 1.472-3 in the case of a taxpayer electing to use a LIFO inventory method for the first time, or in the case of a taxpayer changing to the dollar-value method and continuing to use the same pools as were used under another LIFO method, a taxpayer using another LIFO method of pricing inventories may not change to the dollar-value method of pricing such inventories unless he first secures the consent of the Commissioner in accordance with paragraph (e) of § 1.446-1.

(2) *Method of converting inventory.* Where the taxpayer changes from one method of pricing LIFO inventories to the dollar-value method, the ending LIFO inventory for the taxable year immediately preceding the year of change shall be converted to the dollar-value LIFO method. This is done to establish the base-year cost for subsequent calculations. Thus, if the taxpayer was previously valuing LIFO inventories on the specific goods method, these separate values shall be combined into appropriate pools. For this purpose, the base year for the pool shall be the earliest taxable year for which the LIFO inventory method had been adopted for any item in that pool. No change will be made in the overall LIFO value of the opening inventory for the year of change as a result of the conversion, and that inventory will merely be restated in the manner used under the dollar-value method. All layers of increment for such inventory must be retained, except that all layers of increment which occurred in the same taxable year must be combined. The following examples illustrate the provisions of this subparagraph:

§ 1.472-8

26 CFR Ch. I (4-1-01 Edition)

*Example (1).* (i) Assume that the taxpayer has used another LIFO method for finished goods since 1954 and has complied with all the requirements prerequisite for a change to the dollar-value method. Items A, B, and C, which have previously been inventoried under the specific goods LIFO method, may properly be included in a single dollar-value LIFO pool. The LIFO inventory value of items A, B, and C at December 31, 1960, is \$12,200, computed as follows:

Year	Base quantity and year-ly increments	Unit cost	Dec. 31, 1960, inventory at LIFO value
<i>Item A</i>			
1954 (base year) .....	100	\$1	\$100
1955 .....	200	2	400
1956 .....	100	4	400
1960 .....	100	6	600
Total .....	500		1,500
<i>Item B</i>			
1954 (base year) .....	300	6	1,800

Year	Base quantity and year-ly increments	Unit cost	Dec. 31, 1960, inventory at LIFO value
1955 .....	100	8	800
1960 .....	50	10	500
Total .....	450		3,100
<i>Item C</i>			
1954 (base year) .....	1,000	4	4,000
1955 .....	200	6	1,200
1956 .....	300	8	2,400
Total .....	1,500		7,600
LIFO value of items A, B, and C at Dec. 31, 1960 .....			12,200

There were no increments in the years 1957, 1958, or 1959.

(ii) The computation of the ratio of the total current-year cost to the total base-year cost for the base year and each layer of increment in Pool No. 1 is shown as follows:

Item	1954 base- year unit cost	Year 1954	Increments		
			1955	1956	1960
<i>A</i>					
Base-year cost .....	\$1.00	\$100	\$200	\$100	\$100
LIFO value .....		100	400	400	600
<i>B</i>					
Base-year cost .....	6.00	1,800	600		300
LIFO value .....		1,800	800		500
<i>C</i>					
Base-year cost .....	4.00	4,000	800	1,200	
LIFO value .....		4,000	1,200	2,400	
Total—Base-year cost .....	5,900	1,600	1,300	400	
Total—LIFO value .....	5,900	2,400	2,800	1,100	
Ratio of total current-year cost to total base-year cost (per- cent) .....		100.00	150.00	215.38	275.00

(iii) On the basis of the foregoing computations, the LIFO inventory of Pool No. 1, at December 31, 1960, is restated as follows:

	Dec. 31, 1960, inventory at base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1960, inventory at LIFO value
1954 base cost .....	\$5,900	100.00	\$5,900
1955 increment .....	1,600	150.00	2,400
1956 increment .....	1,300	215.38	2,800
1960 increment .....	400	275.00	1,100
Total .....	9,200		12,200

*Example (2).* Assume the same facts as in example (1) and assume further that the

base-year cost of Pool No. 1 at December 31, 1961, is \$8,350. Since the closing inventory for the taxable year 1961 at base-year cost is less than the opening inventory for that year at base-year cost, a liquidation has occurred during 1961. This liquidation absorbs all of the 1960 layer of increment and part of the 1956 layer of increment. The December 31, 1961, inventory is \$10,131, computed as follows:

	Dec. 31, 1961, inventory at base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1961, inventory at LIFO value
1954 base cost .....	\$5,900	100.00	\$5,900

	Dec. 31, 1961, in- ventory at base-year cost	Ratio of total cur- rent-year cost to total base- year cost (percent)	Dec. 31, 1961, in- ventory at LIFO value
1955 increment .....	1,600	150.00	2,400
1956 increment .....	850	215.38	1,831
Total .....	8,350	.....	10,131

(g) *Transitional rules*—(1) *Change in method of pooling.* Any method of pooling authorized by this section and used by the taxpayer in computing his LIFO inventories under the dollar-value method shall be treated as a method of accounting. Any method of pooling which is authorized by this section shall be used for the year of adoption and for all subsequent taxable years unless a change is required by the Commissioner in order to clearly reflect income, or unless permission to change is granted by the Commissioner as provided in paragraph (e) of § 1.446-1. Where the taxpayer changes from one method of pooling to another method of pooling permitted by this section, the ending LIFO inventory for the taxable year preceding the year of change shall be restated under the new method of pooling.

(2) *Manner of combining or separating dollar-value pools.* (i) A taxpayer who has been using the dollar-value LIFO method and who is permitted or required to change his method of pooling, shall combine or separate the LIFO value of his inventory for the base year and each yearly layer of increment in order to conform to the new pool or pools. Each yearly layer of increment in the new pool or pools must be separately accounted for and a record thereof maintained, and any liquidation occurring in the new pool or pools subsequent to the formation thereof shall be treated in the same manner as if the new pool or pools had existed from the date the taxpayer first adopted the LIFO inventory method. The combination or separation of the LIFO value of his inventory for the base year and each yearly layer of increment shall be made in accordance with the appropriate method set forth in this subparagraph, unless the use of a different method is approved by the Commissioner.

(ii) Where the taxpayer is permitted or required to separate a pool into more than one pool, the separation shall be made in the following manner: First, each item in the former pool shall be placed in an appropriate new pool. Every item in each new pool is then extended at its base-year unit cost and the extensions are totaled. Each total is the amount of inventory for each new pool expressed in terms of base-year cost. Then a ratio of the total base-year cost of each new pool to the base-year cost of the former pool is computed. The resulting ratio is applied to the amount of inventory for the base year and each yearly layer of increment of the former pool to obtain an allocation to each new pool of the base-year inventory of the former pool and subsequent layers of increment thereof. The foregoing may be illustrated by the following example of a change for the taxable year 1961:

*Example.* (a) Assume that items A, B, C, and D are all grouped together in one pool prior to December 31, 1960. The LIFO inventory value at December 31, 1960, is computed as follows:

	Pool ABCD		
	Dec. 31, 1960, in- ventory at Jan. 1, 1956, base-year cost	Ratio of total cur- rent-year cost to total base- year cost (percent)	Dec. 31, 1960, in- ventory at LIFO value
Jan. 1, 1956, base cost .....	\$10,000	100	\$10,000
Dec. 31, 1956, increment .....	1,000	110	1,100
Dec. 31, 1958, increment .....	5,000	120	6,000
Dec. 31, 1960, increment .....	4,000	125	5,000
Total .....	20,000	.....	22,100

(b) The extension of the quantity of items A, B, C, and D at respective base-year unit costs is as follows:

Item	Quan- tity	Base- year unit cost	Amount
A .....	2,000	\$2	\$4,000
B .....	1,000	3	3,000
C .....	1,000	5	5,000
D .....	4,000	2	8,000
Total .....	.....	.....	20,000

(c) Under the provisions of this section the taxpayer separates former Pool ABCD into

§ 1.472-8

two pools, Pool AB and Pool CD. The computation of the ratio of total base-year cost for each of the new pools to the base-year cost of the former pool is as follows:

Item	Total base-year cost	Ratio
Pool AB:		
A .....	\$4,000	.....
B .....	3,000	.....
	7,000	7,000/20,000
Pool CD:		
C .....	5,000	.....
D .....	8,000	.....
	13,000	13,000/20,000
Total for pool ABCD .....	20,000	.....

(d) The ratio of the base-year cost of new Pools AB and CD to the base-year cost of former Pool ABCD is 7,000/20,000 and 13,000/20,000, respectively. The allocation of the January 1, 1956 base cost and subsequent yearly layers of increment of former Pool ABCD to new Pools AB and CD is as follows:

	Base-year cost to be allocated	Pool	
		AB	CD
Jan. 1, 1956, base cost .....	\$10,000	\$3,500	\$6,500
Dec. 31, 1956, increment .....	1,000	350	650
Dec. 31, 1958, increment .....	5,000	1,750	3,250
Dec. 31, 1960, increment ..	4,000	1,400	2,600
Total .....	20,000	7,000	13,000

(e) The LIFO value of new Pools AB and CD at December 31, 1960, as allocated, is as follows:

	Dec. 31, 1960, inventory at Jan. 1, 1956, base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1960, inventory at LIFO value
<i>Pool AB</i>			
Jan. 1, 1956, base cost .....	\$3,500	100	\$3,500
Dec. 31, 1956, increment .....	350	110	385
Dec. 31, 1958, increment .....	1,750	20	2,100
Dec. 31, 1960, increment .....	1,400	125	1,750
Total .....	7,000	.....	7,735
<i>Pool CD</i>			
Jan. 1, 1956, base cost .....	6,500	100	6,500
Dec. 31, 1956, increment .....	650	110	715
Dec. 31, 1958, increment .....	3,250	120	3,900

26 CFR Ch. I (4-1-01 Edition)

	Dec. 31, 1960, inventory at Jan. 1, 1956, base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1960, inventory at LIFO value
Dec. 31, 1960, increment .....	2,600	125	3,250
Total .....	13,000	.....	14,365

(iii) Where the taxpayer is permitted or required to combine two or more pools having the same base year, they shall be combined into one pool in the following manner: The LIFO value of the base-year inventory of each of the former pools is combined to obtain a LIFO value of the base-year inventory for the new pool. Then, any layers of increment in the various pools which occurred in the same taxable year are combined into one total layer of increment for that taxable year. However, layers of increment which occurred in different taxable years may not be combined. In combining the layers of increment a new ratio of current-year cost to base-year cost is computed for each of the combined layers of increment. The foregoing may be illustrated by the following example:

*Example.* (a) Assume the taxpayer has two pools at December 31, 1960. Under the provisions of this section the taxpayer combines these pools into a single pool as of January 1, 1961. The LIFO inventory value of each pool at December 31, 1960, is shown as follows:

	Dec. 31, 1960, inventory at Jan. 1, 1957, base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1960, inventory at LIFO value
<i>Pool No. 1</i>			
Jan. 1, 1956, base cost .....	\$10,000	100	\$10,000
Dec. 31, 1957, increment .....	2,000	110	2,200
Dec. 31, 1960, increment .....	1,000	120	1,200
Total .....	13,000	.....	13,400
<i>Pool No. 2</i>			
Jan. 1, 1957, base cost .....	5,000	100	5,000
Dec. 31, 1960, increment .....	3,000	140	4,200
Total .....	8,000	.....	9,200

(b) The computation of the ratio of the total current-year cost to the total base-year cost for the base year and each yearly layer of increment in the new pool is as follows:

## Internal Revenue Service, Treasury

## § 1.472-8

Pool	Base year 1957	Increments	
		Dec. 31, 1957	Dec. 31, 1960
No. 1:			
Base-year cost .....	\$10,000	\$2,000	\$1,000
LIFO value .....	10,000	2,200	1,200
No. 2:			
Base-year cost .....	5,000	.....	3,000
LIFO value .....	5,000	.....	4,200
Total, base-year cost .....	15,000	2,000	4,000
Total, LIFO value .....	15,000	2,200	5,400
Ratio of total current-year cost to total base-year cost (percent) .....	100	110	135

(c) On the basis of the foregoing computations, the LIFO inventory of the new pool at December 31, 1960, is restated as follows:

	Dec. 31, 1960, inventory at Jan. 1, 1957, base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1960, inventory at LIFO value
Jan. 1, 1957, base cost .....	\$15,000	100	\$15,000
Dec. 31, 1957, increment .....	2,000	110	2,200
Dec. 31, 1960, increment .....	4,000	135	5,400
Total .....	21,000	.....	22,600

(iv) In combining pools having different base years, the principles set forth in subdivision (iii) of this subparagraph are to be applied, except that all base years subsequent to the earliest base year shall be treated as increments, and the base-year costs for all pools having a base year subsequent to the earliest base year of any pool shall be redetermined in terms of the base cost for the earliest base year. The foregoing may be illustrated by the following example:

*Example.* (a) Assume that the taxpayer has two pools at December 31, 1960. Under the provisions of this section the taxpayer combines these pools into a single pool as of January 1, 1961. The LIFO inventory value of each pool at December 31, 1960, is shown as follows:

	Dec. 31, 1960, inventory at Jan. 1, 1956, base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1960, inventory at LIFO value
<i>Pool No. 1</i>			
Jan. 1, 1956, base cost .....	\$7,000	100	\$7,000
Dec. 31, 1956, increment .....	1,000	105	1,050
Dec. 31, 1957, increment .....	500	110	550
Dec. 31, 1958, increment .....	500	110	550
Dec. 31, 1960, increment .....	1,000	120	1,200
Total .....	10,000	.....	10,350
<i>Pool No. 2</i>			
Jan. 1, 1958, base cost .....	3,500	100	3,500
Dec. 31, 1958, increment .....	1,000	110	1,100
Dec. 31, 1959, increment .....	500	115	575
Total .....	5,000	.....	5,175

(b) The next step is to redetermine the 1958 base-year cost for Pool No. 2 in terms of 1956 base-year cost. January 1, 1956 base-year unit cost must be reconstructed or established in accordance with paragraph (e)(2) of this section for each item in Pool No. 2. Such costs are assumed to be \$9.00 for item A, \$20.00 for item B, and \$1.80 for item C. A ratio of the 1958 total base-year cost to the 1956 total base-year cost for Pool No. 2 is computed as follows:

Item	Quantity	Jan. 1, 1956, base-year unit cost	Jan. 1, 1956, base-year cost
A .....	250	\$9.00	\$2,250
B .....	75	20.00	1,500
C .....	500	1.80	900
Total .....	.....	.....	4,650
A .....	250	10.00	2,500
B .....	75	20.00	1,500
C .....	500	2.00	1,000
Total .....	.....	.....	5,000

(c) The ratio of the 1956 total base-year cost to the 1958 total base-year cost for Pool No. 2 is 4,650/5,000 or 93 percent. The January 1, 1958 base cost and each yearly layer of increment at 1958 base-year cost is multiplied

§ 1.472-8

26 CFR Ch. I (4-1-01 Edition)

by this ratio. Such computation is as follows:

	Dec. 31, 1960, inventory at Jan. 1, 1958, base-year cost	Ratio (per-cent)	Dec. 31, 1960, inventory re-stated at Jan. 1, 1956, base-year cost
Jan. 1, 1958, base cost	\$3,500	93	\$3,255
Dec. 31, 1958, increment	1,000	93	930
Dec. 31, 1959, increment	500	93	465

	Dec. 31, 1960, inventory at Jan. 1, 1958, base-year cost	Ratio (per-cent)	Dec. 31, 1960, inventory re-stated at Jan. 1, 1956, base-year cost
Total	5,000	93	4,650

(d) The computation of the ratio of the total current-year cost to the total base-year cost for the base year (1956) and each yearly layer of increment in the new pool is as follows:

Pool	Base year 1956	Increments				
		Dec. 31, 1956	Dec. 31, 1957	Dec. 31, 1958	Dec. 31, 1959	Dec. 31, 1960
No. 1:						
Base-year cost	\$7,000	\$1,000	\$500	\$500		\$1,000
LIFO value	7,000	1,050	550	550		1,200
No. 2:						
Base-year cost as restated			3,255	930	\$465	
LIFO value			3,500	1,100	575	
Total, base-year cost	7,000	1,000	3,755	1,430	465	1,000
Total, LIFO value	7,000	1,050	4,050	1,650	575	1,200
Ratio of total current-year cost to total base-year cost (percent)	100.00	105.00	107.86	115.38	133.66	120.00

(e) On the basis of the foregoing computation, the LIFO inventory of the new pool at December 31, 1960, is restated as follows:

	Dec. 31, 1960, inventory at Jan. 1, 1956, base-year cost	Ratio of total current-year cost to total base-year cost (percent)	Dec. 31, 1960, inventory at LIFO value
Jan. 1, 1956, base cost	\$7,000	100.00	\$7,000
Dec. 31, 1956, increment	1,000	105.00	1,050
Dec. 31, 1957, increment	3,755	107.86	4,050
Dec. 31, 1958, increment	1,430	115.38	1,650
Dec. 31, 1959, increment	465	123.66	575
Dec. 31, 1960, increment	1,000	120.00	1,200
Total	14,650		15,525

paragraph (e)(1) of this section, he shall not be required to recompute his LIFO inventories for taxable years beginning on or before December 31, 1960, under a method authorized by such paragraph. The base cost and layers of increment previously computed by such other method shall be retained and treated as if such base cost and layers of increment had been computed under a method authorized by paragraph (e)(1) of this section. The taxpayer shall use the year of change as the base year in applying the double-extension method or other method approved by the Commissioner, instead of the earliest year for which he adopted the LIFO method for any items in the pool.

(3) *Change in methods of computation at the LIFO value of a dollar-value pool.* For the first taxable year beginning after December 31, 1960, the taxpayer must use a method authorized by paragraph (e)(1) of this section in computing the base-year cost and current-year cost of a dollar-value inventory pool for the end of such year. If the taxpayer had previously used any methods other than one authorized by

(h) *Change without consent in method of pooling—(1) Authorization.* Notwithstanding the provisions of paragraph (g) of this section, a taxpayer, for his first taxable year ending after April 15, 1961, may change from one method of pooling authorized by this section to any other method of pooling authorized by this section provided the requirements of subparagraph (2) of this paragraph are met. Also, for such year, if a

## Internal Revenue Service, Treasury

## § 1.475-0

taxpayer is currently using only a method of pooling authorized by this section, or a method of pooling which would be authorized by this section if additional items were included in the pool, and could change to the natural business unit method, except for the fact he has not inventoried all items entering into the inventory investment for such natural business unit on the LIFO method, he may change to the natural business unit method if he elects under the provisions of § 1.472-3 to extend the LIFO election to all items entering into the entire inventory investment for such natural business unit, provided the requirements of subparagraph (2) of this paragraph are met. The method of pooling adopted shall be used for the year of change and for all subsequent taxable years unless a change is required by the Commissioner in order to clearly reflect income, or unless permission to change is granted by the Commission as provided in paragraph (e) of § 1.446-1.

(2) *Requirements.* A statement shall be attached to the income tax return for the year of change referred to in subparagraph (1) of this paragraph setting forth, in summary form, the following information:

- (i) A description of the new pool or pools,
- (ii) The basis for selection of the new pool or pools,
- (iii) A schedule showing the computation of the LIFO value of the former pool or pools, and,
- (iv) A schedule showing the transition from the former pool or pools to the new pool or pools.

In addition, a copy of the statement shall be filed with the Commissioner of Internal Revenue, Attention: T:R, Washington, DC 20024. The taxpayer shall submit such other information with respect to the change in method of pooling as may be requested.

[T.D. 6539, 26 FR 518, Jan. 20, 1961, as amended by T.D. 7814, 47 FR 11272, Mar. 16, 1982]

### § 1.475-0 Table of contents.

This section lists the major captions in §§ 1.475(a)-3, 1.475(b)-1, 1.475(b)-2, 1.475(b)-4, 1.475(c)-1, 1.475(c)-2, 1.475(d)-1, and 1.475(e)-1.

### §§ 1.475(a)-1—1.475(a)-2 [Reserved]

### § 1.475(a)-3 Acquisition by a dealer of a security with a substituted basis.

- (a) Scope.
- (b) Rules.

### § 1.475(b)-1 Scope of exemptions from mark-to-market requirement.

- (a) Securities held for investment or not held for sale.
- (b) Securities deemed identified as held for investment.
  - (1) In general.
  - (2) Relationships.
    - (i) General rule.
    - (ii) Attribution.
    - (iii) Trusts treated as partnerships.
  - (3) Securities traded on certain established financial markets.
  - (4) Changes in status.
    - (i) Onset of prohibition against marking.
    - (ii) Termination of prohibition against marking.
    - (iii) Examples.
  - (c) Securities deemed not held for investment; dealers in notional principal contracts and derivatives.
  - (d) Special rule for hedges of another member's risk.
  - (e) Transitional rules.
    - (1) Stock, partnership, and beneficial ownership interests in certain controlled corporations, partnerships, and trusts before January 23, 1997.
      - (i) In general.
      - (ii) Control defined.
      - (iii) Applicability.
    - (2) Dealers in notional principal contracts and derivatives acquired before January 23, 1997.
      - (i) General rule.
      - (ii) Exception for securities not acquired in dealer capacity.
      - (iii) Applicability.

### § 1.475(b)-2 Exemptions—identification requirements.

- (a) Identification of the basis for exemption.
- (b) Time for identifying a security with a substituted basis.
- (c) Integrated transactions under § 1.1275-6.
  - (1) Definitions.
  - (2) Synthetic debt held by a taxpayer as a result of legging in.
  - (3) Securities held after legging out.

### § 1.475(b)-3 [Reserved]

### § 1.475(b)-4 Exemptions—transitional issues.

- (a) Transitional identification.
  - (1) Certain securities previously identified under section 1236.
  - (2) Consistency requirement for other securities.